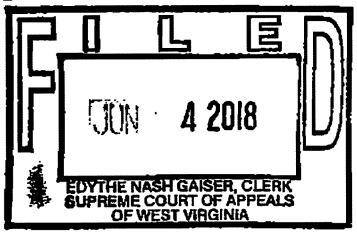
IN THE

SUPREME COURT OF APPEALS OF WEST VIRGINIA

Case No. 18-0513



SIERRA CLUB,

Petitioner;

v.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,

Respondent.

On Appeal from the
Public Service Commission of West Virginia

OPENING BRIEF OF THE PETITIONER

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ASSIGNMENTS OF ERROR

1. The Commission erred by approving as "just and reasonable to the electric consumer and in the public interest" rates associated with a voluntary agreement between a public utility and a merchant electricity generator based solely on regulations implementing the federal Public Utility Regulatory Policies Act and not on the statutory ratemaking principles contained in Chapter 24 of the West Virginia Code.

2. In the alternative, to the extent regulations implementing the Public Utility Regulatory Policies Act apply to the Commission's approval of rates associated with a voluntary agreement between a public utility and a merchant generator, the Commission erred by failing to assess those rates according to the utility's avoided cost at the time it entered into that agreement.

STATEMENT OF THE CASE

Petitioner Sierra Club challenges the West Virginia Public Service Commission's decision allowing the Monongahela Power Company (Mon Power) to burden its customers with higher retail rates as a result of the Company's voluntary decision to pay higher capacity rates for the purchase of electricity from a failing power plant owned by American Bituminous Power Partners (AmBit). *See American Bituminous Power Partners et al.*, Case No. 17-0631-E-P, Commission Order (May 3, 2018) (the 2018 Order), App. at A-171. Before the Commission can authorize such a pass-through, West Virginia law requires it ensure the resulting customer rates and charges are just and reasonable. Nevertheless, the Commission undertook no analysis whatsoever of the impact its Order would have on Mon Power's customers or of the alternatives to purchasing electricity from AmBit's increasingly expensive plant. 2018 Order at 33 (Conclusions of Law Nos. 22, 25–27), App. at A-205.

Instead, it accepted the companies' bid for a ratepayer-funded bailout based on a novel misreading of the federal Public Utilities Regulatory Policy Act (PURPA), 16 U.S.C.

§ 824a-3, and its implementing regulations. 2018 Order at 14–15, 24, 33 (Conclusions of Law Nos. 22, 25–26), App. at A-186-187, A-196, A-205. By way of this creative bookkeeping, the Order forces Mon Power customers to bear the consequences of Mon Power and AmBit's voluntary decision to amend their electric energy purchase agreement (EEPA). Specifically, the Commission authorized an increase of the capacity rate[1] to be paid between 2017 and 2035 from $27 to $34.25 per megawatt-hour.[2] *See* 2018 Order at 30 (Finding of Fact No. 32), 33 (Conclusions of Law Nos. 22, 25–26), App. at A-202, A-205.

Beneath the conceptual gymnastics that led the Commission to its decision, the questions on appeal are relatively simple. First, by assuming that any voluntarily amendment to the EEPA was just and reasonable simply by virtue of the Grant Town plant's status as a "qualifying facility" under PURPA, did the Commission abdicate its statutory duty to ensure the pass-through of Mon Power's costs under the amended EEPA was just and reasonable under traditional ratemaking principles? And second, even assuming the Commission's PURPA regulations applied to the voluntary amendment, was the Commission justified in evaluating that amendment according to the cost and availability of alternatives to AmBit's plant in 1987 rather than at present? Because this Court is unable to answer either of these questions in the affirmative, it

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1 Like many similar agreements under PURPA, the agreement includes both "energy cost" and "capacity cost" components. Energy costs are the variable costs associated with generating electricity—for example, the cost of fuel and some operating and maintenance expenses. Capacity costs are those associated with providing the capability to produce and deliver energy—primarily the capital costs of facilities. *See Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, 45 Fed. Reg. 12214, 12216 (February 25, 1980).

2 During the course of proceedings before the Commission regarding AmBit and Mon Power's EEPA, both "dollars per megawatt-hour" (MWh) and "cents per kilowatt-hour" were used when referring to capacity and energy rates. The two metrics are easily convertible—*e.g.*, 2.63 cents per kilowatt-hour is equivalent to $26.30/MWh.

must remand to the Commission for a full consideration of the impact the agreement will have on Mon Power's ratepayers.

I. Statutory and Regulatory Framework

A. The Commission's Traditional Ratemaking Authority: A Duty to Ensure Rates are "Just and Reasonable"

West Virginians inherit from Anglo-American common law a right to reasonable rates from any state-sanctioned monopoly. *See generally State ex rel. Knight v. Public Service Commission*, 161 W. Va. 447, 245 S.E.2d 144 (1978). Because electric utilities do not face the same incentives to minimize costs as do actors in a competitive marketplace, the State has a duty to regulate rates and services so as to promote economic efficiency. *See New Orleans Public Services v. City Council of New Orleans*, 491 U.S. 350, 365, 109 S. Ct. 2506 (1989) ("[T]he regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States.") (quoting *Arkansas Electric Cooperative v. Arkansas Public Service Commission*, 461 U.S. 375, 377, 103 S. Ct. 1905 (1983)).

The Legislature created the Public Service Commission to exercise regulatory authority over utilities and to "protect the public from unfair rates and practices." *State ex rel. Water Development Authority v. Northern Wayne County Public Service District*, 195 W. Va. 135, 141, 464 S.E.2d 777, 783 (1995). While it must exercise this authority in a manner that is not confiscatory toward the utilities under its purview, *Bluefield Waterworks & Improvement v. West Virginia Public Service Commission*, 262 U.S. 679, 43 S. Ct. 675 (1923), the Commission's "primary purpose is to serve the interests of the public." *Mountain Communities for Responsible Energy v. Public Service Commission*, 222 W. Va. 481, 491, 665 S.E.2d 315, 325 (2008).

Central to that charge is the Commission's ratemaking authority. West Virginia Code § 24-2-3(a) empowers the Commission "to enforce, originate, establish, change and promulgate tariffs, rates, joint rates, tolls and schedules for all public utilities." In so doing, it must "[e]nsure that rates and charges for utility services are just, reasonable, [and] applied without unjust discrimination or preference." West Virginia Code § 24-1-1(a)(4).

Ratemaking cannot be reduced to "any precise formula [or] ultimate test," *Monongahela Power v. Public Service Commission*, 166 W. Va. 423, 426, 276 S.E.2d 179, 182 (1981), and the Commission is not bound to employ any single methodology, *C & P Telephone v. Public Service Commission*, 171 W. Va. 708, 715, 301 S.E.2d 798, 804 (1983). However, as a "creature of statute," the Commission must nonetheless exercise its jurisdiction according to statutory mandates. *Eureka Pipe Line v. Public Service Commission*, 148 W. Va. 674, 682, 137 S.E.2d 200, 204 (1964).

Importantly, the Code requires that utility rates be "based primarily on the costs of providing [the] services." West Virginia Code § 24-1-1(a)(4). *See also id.* § 24-2-2(a) ("[I]n no case shall the rate . . . be more than the [utility] service is reasonably worth, considering the cost of the service"). It also requires the Commission to consider "the general interests of the state's economy and the interests of the utilities" when setting rates. West Virginia Code § 24-1-1(b). As the Commission has recognized, this includes a consideration of "local and regional externalities," such as employment effects, environmental impacts, the attraction of capital to the state, and expansion of the State's tax base. *Monongahela Power*, Case No. 17-0296-E-PC, Commission Order, 3, 17 & n.6 (January 26, 2018). And in light of the reality that "today's customers are not necessarily tomorrow's," *Knight*, 161 W. Va. at 462, 245 S.E.2d at 152, the Legislature requires the

Commission "balanc[e] the interests of current and future utility service customers" in ratemaking cases. West Virginia Code § 24-1-1(b). These constraints on the ratemaking authority also demonstrate that any decision to increase rates "must depend upon and be controlled by its own peculiar facts." *Bluefield Waterworks & Improvement v. Public Service Commission*, 89 W. Va. 736, 110 S.E. 205, Syl. Pt. 2 (1921), *overturned on other grounds* 262 U.S. 679, 43 S. Ct. 675 (1923).

B. The Federal Public Utility Regulatory Policies Act

Although utility regulation is "traditionally associated with the police power of the States," *New Orleans*, 491 U.S. at 365, the interstate nature of the electricity system allows limited federal involvement in this exercise. *See generally FERC v. Mississippi*, 456 U.S. 742, 102 S. Ct. 2126 (1982). Congress decided to occupy a narrow corner of that regulatory field after the 1973 oil embargo revealed that the industry's heavy reliance on oil- and natural gas-fired generation had serious economic and national security implications. *Id.* at 745, 756–57. *See also American Bituminous Power Partners*, Case No. 87-0669-E-P, Commission Order, 21 (October 17, 2016), App. at A-115, A-137.

The Public Utility Regulatory Policies Act of 1978 (PURPA) sought to ease the nation's reliance on traditional fossil fuels by encouraging the use of emerging and non-traditional technologies—including renewable energy resources, waste-to-energy plants, and more efficient generation. *Mississippi*, 456 U.S. at 750. Despite the promise of these resources, they faced several structural and economic impediments to widespread deployment. For one, electric utilities were reluctant to purchase energy from them. *Id.* And because of their unique operating characteristics, they did not fit comfortably into traditional models of utility regulation. *Id.*

Section 210 of the Act, 16 U.S.C. § 824a-3, attempts to address these impediments by compelling electric utilities to purchase the electrical output from so-called "qualifying facilities" (QFs), subject to certain terms and conditions. Qualifying facilities include both "small power production facilities"—small power plants fueled primarily by renewable resources or waste products—and "cogeneration facilities"—fossil fuel-fired power plants that recycle their waste heat or steam for some other useful purpose. *See* 16 U.S.C. §§ 796(17)(A), 786(18)(A).

As implemented by the Federal Energy Regulatory Commission (FERC), Section 210 may be used to require electric utilities to purchase power from QFs at a rate equal to the utility's "avoided cost"—the incremental cost the utility would have incurred by generating the electricity itself or by purchasing it from another source. 16 U.S.C. § 824a-3(a); 18 C.F.R. §§ 292.303, 292.304(a), 292.101(b)(6).

Congress acknowledged that this avoided cost might exceed the amount that state utility regulators would otherwise approve for recovery under traditional cost-of-service regulation. However, PURPA declares those costs to be just, reasonable, and in the public interest as a matter of law, in the event of a compelled purchase. 18 C.F.R. § 292.304(b)(2). *See also* 16 U.S.C. § 824a-3(m)(7) (requiring FERC to issue regulations ensuring utilities fully recover all costs incurred "in accordance with any legally enforceable obligation entered into or imposed under" Section 210). The practical effect is to shield utilities from any possibility that regulators will prohibit them from recovering the costs they are forced to incur in furtherance of PURPA's federal policy of energy independence and national security. PURPA's legislative history makes clear that Congress did not intend that QFs be "subject . . . to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and

reasonable rate that they should receive for their electric power." H.R. Report No. 95-1750, at 97 (1978) (Conference Report). *See also American Paper Institute v. American Electric Power*, 461 U.S. 402, 414 (1983) (despite statutory requirement of "just and reasonable" rates—a standard familiar to traditional "cost-of-service utility ratemaking"—Congress "did not intend to impose traditional ratemaking concepts" to PURPA transactions).

PURPA does not, however, apply to every purchase between a utility and a QF. The law allows parties to negotiate freely over terms—including energy and capacity rates—and federal regulations implementing PURPA clarify that nothing in the law affects the validity of a contract freely entered into between a utility and a QF for energy purchase. *See* 18 C.F.R. § 292.301(b). Rather, PURPA's avoided cost rule "simply establishes the rate that applies in the absence of . . . a specific contractual agreement" as to rates. *American Paper*, 461 U.S. at 416. By contrast, "privately negotiated contracts for QF power are essentially outside the federal and state [PURPA] rules." *Barasch v. Pennsylvania Public Utility Commission*, 546 A.2d 1296, 1300 (Pa. Commw. 1988).

C. The Commission's Electric Rule 12

State utility commissions play an important role under PURPA. Section 210(f) requires that regulatory agencies enact rules implementing PURPA's statutory requirements for the utilities under their authority. 16 U.S.C. § 824a-3(f). The agencies' so-called "implementation jurisdiction" under PURPA also includes resolving disputes between utilities and QFs regarding the calculation of avoided cost and other rights and obligations under the Act. *Mississippi*, 456 U.S. at 751.

West Virginia Code § 24-2-13 grants the Commission the state-level authority it

needs to implement PURPA. The statute, however, only authorizes the Commission to perform "those duties expressly conferred upon a state regulatory authority by the . . . Act," and only "insofar as [PURPA is] not repugnant to the laws of this state or contrary to the [Commission's] rules and regulations." *Id.* In other words, the traditional regulatory principles outlined in the Code remain undisturbed except where expressly preempted by federal law. *See, e.g., City of New Martinsville v. Public Service Commission*, 229 W. Va. 353, 361, 729 S.E.2d 188, 196 (2012) (holding that PURPA does not preempt Commission's authority to interpret certain terms of QF contract). *Cf. American Bituminous Power Partners*, Case No. 87-669-E-C, Commission Order, 5 & n.1 (March 29, 1996) (the 1996 Order), App. at A-092, A-096 (PURPA preempted Commission's authority to approve unilateral amendment to QF contract).

Armed with this statutory authority, the Commission amended its Rules and Regulations for the Government of Electric Utilities (Electric Rules) to include a new Rule 12: "Cogeneration and Small Power Production." West Virginia C.S.R. § 150-3-12. Rule 12 largely mirrors FERC's Section 210 regulations—and, as a consequence, also resembles its regulatory counterparts in others states. *See, e.g., Texas Public Utility Commission v. Gulf States Utilities*, 809 S.W.2d 201, 208 (Tex. 1991) (recognizing similarity between Texas PURPA regulations and their federal counterpart); *American Bituminous Power Partners*, Case No. 87-669-E-C, Commission Order, Oct. 17, 2016, at 33 (the 2016 Order), App. at A-149 (recognizing similarity between Rule 12 and Texas regulations).

Rule 12.4 implements PURPA's mandatory purchase requirement and provides that "[e]ach electric utility shall purchase . . . any energy and capacity which is made available from a qualifying facility" in accordance with Rule 12.6's rate requirements.

West Virginia C.S.R. § 150-3-12.4.a. Rule 12.6, in turn, generally requires that rates for QF purchases under PURPA be "just and reasonable to the electric consumer and in the public interest," *Id.* § 150-3-12.6.a.1, and provides that a rate equal to the utility's avoided cost automatically "satisfies th[ose] requirements." *Id.* § 150-3-12.6.b.2.

The scope of the Commission's PURPA implementation authority is limited, however, by Rule 12.2. *Id.* § 150-3-12.2. Like its federal counterpart, 18 C.F.R. § 292.301(b), Rule 12 does not prevent utilities and QFs from voluntarily agreeing to rates that differ from those "otherwise required by th[e] rule." West Virginia C.S.R. § 150-3-12.2.b.1. Nor does anything in Rule 12 "[a]ffect the validity of any contract entered into between a qualifying facility and an electric utility for any purchase" of electricity. *Id.* § 150-3-12.2.b.2.

II. Facts and Material Proceedings Below

A. The Original Electric Energy Purchase Agreement

AmBit is a limited partnership organized to own and operate the Grant Town plant in Marion County, West Virginia. 2018 Order at 1, App. at A-171. The 80-megawatt plant generates electricity by burning a mixture of coal and waste coal and is thereby deemed a qualifying facility under PURPA. *Id.* Accordingly, AmBit is entitled to sell the plant's energy output and capacity to a utility for the utility's avoided cost. *Id.* Since commencement of plant operation, AmBit has sold the power generated at Grant Town to Mon Power pursuant to an Electric Energy Purchase Agreement (EEPA). *Id.*

In 1987, AmBit filed a complaint against Mon Power asking the Commission to require Mon Power to enter into a contract for the sale and purchase of power from the Grant Town plant. *Id* at 3, App. at A-174. Noting that "[t]he calculation of avoided costs

is not an exact science," the Commission issued an order setting the energy and capacity rates, contract length, and other disputed terms. *American Bituminous Power Partners v. Monongahela Power Co.*, Case No. 87-669-E-C, Commission Order (November 13, 1987) (the 1987 Order) App. at A-001, A-006. The 1987 Order set a contract term of thirty-five years and authorized an avoided cost rate of 4.53 cents per kilowatt-hour, which included a fixed capacity rate of 2.63 cents per kilowatt-hour ($26.30/MWh) and a variable energy rate of 1.9 cents per kilowatt-hour ($19/MWh) tied to a capped tracking account. 1987 Order at 4–5, 13–15, App at A-004–A-005, A-013–A-015. *See also* 2018 Order at 27 (Findings of Fact Nos. 5–7), App. at A-199. The following year, AmBit and Mon Power sought Commission approval of a proposed EEPA that included a revised $27.25/MWh capacity rate and approval of the pass-through of power purchase costs to Mon Power's customers; the Commission granted the requests. *American Bituminous Power Partners v. Monongahela Power*, Case No. 87-669-E-C, Commission Order (November 10, 1988) (the 1988 Order), App. at A-086. *See also American Bituminous Power Partners v. Monongahela Power*, Case No. 87-669-E-C, Company Request No. 1 (July 1, 1988) (Electric Energy Purchase Agreement between American Bituminous Power Partners, L.P., as Seller and Monongahela Power Company, as Buyer, dated as of January 15, 1988) (the 1988 EEPA), App. at A-016; 2018 Order at 28 (Finding of Fact No. 15) App. at A-200.

B. AmBit's History of Financial Distress and Regulatory Relief

In 1993, the Grant Town plant commenced operations, and AmBit began selling its output to Mon Power. 2018 Order at 5, 28 (Finding of Fact No. 16) App. at A-177, A-200. In short order, however, AmBit returned to the Commission to seek "emergency

relief" it claimed was necessary to protect the plant against "higher than forecast operating expenses and lower than forecast avoided energy" and the "substantial operating losses and cash flow problems" resulting therefrom. 1996 Order, App. at A-092. *See also* 2018 Order at 5, App. at A-177. The Commission denied AmBit's request, concluding that, after approval of the original EEPA, PURPA preempted the Commission from ordering unilateral modification of its terms. 1996 Order at 5–7 (Conclusion of Law No. 1), App. at A-096–A-098 (citing *Freehold Cogeneration. v. New Jersey Board of Regulatory Commissioners*, 44 F. 3d 1178 (3d Cir. 1995)). In 2000, however, AmBit and Mon Power presented the Commission with a joint proposal to amend the EEPA according to an arbitration settlement between the parties. Reasoning that the parties' agreement on the amendments took the matter outside of the framework of PURPA, the Commission approved the request and modified the EEPA accordingly; those amendments did not alter the capacity rate. *American Bituminous Power Partners v. Monongahela Power Co.*, Case No. 87-669-E-C, Commission Order (August 7, 2000) (the 2000 Order), App. at A-100; 2018 Order at 6, App. at A-178.

The companies found themselves before the Commission yet again in 2006 to request additional amendments to the EEPA. *American Bituminous Power Partners*, Case No. 87-669-E-C, Commission Order (April 13, 2006) (the 2006 Order), App. at A-105; *see also* 2018 Order at 6, App. at A-178. Once more, AmBit represented to the Commission that its financial difficulties would lead to the closure of the Grant Town plant absent an increase in revenues between 2006 and 2017—the period during which AmBit was required to make certain debt service payments on revenue bonds that had been issued by Marion County. 2006 Order at 2, App. at A-106. Specifically, AmBit and Mon Power jointly requested Commission approval of a temporary surcharge that would

raise the $27.25/MWh capacity rate approved in the 1988 Order to $34.25/MWh between 2006 and 2017 and the pass-through of the increased costs to ratepayers. *Id.*

In addition to the capacity rate increase, the companies' jointly proposed amendments included an eight-year extension of the term of the EEPA and provided for the decrease of the capacity rate to $27/MWh between 2017 and 2036. *Id.* The companies represented that the extended term of the EEPA at the reduced cost "will allow AmBit to return value to the West Virginia customers of Mon Power . . . for a longer period than is currently provided under the EEPA." *Id.* As part of their petition, Mon Power provided an estimate of the rate estimate of the increase to the average residential customer, and AmBit claimed that the approval of the requested amendments would provide economic and environmental benefits. *Id.* at 3, App. at A-107. In addition, Commission Staff recommended that the negotiated amendments be approved, and the Consumer Advocate Division did not object. *Id.*

Recognizing the deal that had been struck among the parties, the Commission concluded that "[t]he proposed amendments to the EEPA . . . have been mutually agreed to by all parties, are reasonable, and no party is given an undue advantage over the other, and the public is not adversely affected." *Id.* at 8 (Conclusion of Law No. 3), App. at A-112. The terms of the parties' agreement were not required by PURPA, and the Commission did not make any conclusions with respect to PURPA. Instead, it concluded that the settled-upon amendments—in particular the extended contract term and the lower capacity rate during out-years—represented a negotiated bargain structured to balance the financial needs of the failing plant with the protection of ratepayers.

C. Requests to Amend EEPA to Increase Post-2017 Capacity Rate

Notwithstanding the Commission's approval of exactly what the companies asked

for and claimed was needed to ensure the plant's financial viability, AmBit and Mon Power were back again before the Commission in 2015, seeking amendment of the very terms that they agreed to in 2006. 2016 Order, App. at A-115; *see also* 2018 Order at 7–8, App. at A-179–A-180. The companies argued that because the Commission had approved their 2006 joint request, it should do the same again. They sought approval of amendments to the EEPA that would eliminate the 2017 capacity rate decrease to $27/MWh that was designed to make ratepayers whole following the 2006 capacity rate increase and of the pass-through of a new capacity rate of between $34.25 and $40/MWh for the remainder of the contract term. *Id.* at 11, 36, 47 (Findings of Fact Nos. 12, 17), App. at A-127, A-152, A-163. The Commission's Staff, the Consumer Advocate Division, and two intervenor groups all opposed the petition. *Id.* at 12, 46 (Finding of Fact No. 6), App. at A-128, A-162.

With respect to the jurisdictional questions raised, the Commission observed that "[c]learly we have jurisdiction to review the resulting impact on purchased power costs in connection with the retail rates charged by Mon Power to its customers, which is at least part of the relief requested in the Joint Petition." *Id.* at 3 App. at A-120; *see also, id.* at 4, App. at A-121 ("highlighting "the Commission's independent obligation under state law to ensure that rates and charges for utility services are 'just, reasonable ... and based primarily on the costs of providing those services'") (quoting West Virginia Code § 24-1-1(a)(4)). Moreover, the 2016 Order embraced the holding from a Pennsylvania court: "state public utility commissions have a duty to examine costs of [privately negotiated contracts setting rates for the purchase of power from qualifying facilities] claimed by a utility for the purpose of setting its own rates, and will disallow those found to be excessive." *Id.* (quoting *Barasch v. Pennsylvania Public Utility Commission*, 546 A.2d

at 1300). Thus, the Commission has recognized its authority and duty to determine the reasonableness of an electric utility's retail rates in the context of PURPA contracts and that rates are not per se reasonable where the avoided cost rates in a PURPA contract have been negotiated.

Ultimately, the Commission declined to grant the requested relief. In denying the petition, the Commission concluded that it lacked a sufficient basis for determining whether the proposed amended rates were just and reasonable. *Id.* at 43, 52 (Conclusions of Law Nos. 7, 8, 10), App. at A-159, A-168. The 2016 Order did, however, provide guidance as to the adequacy of a record supporting any future petition that seeks cost recovery based on market rates. *Id.* at 43–44, App. at A-159–A-160.

D. The Immediate Proceedings Below

Rather than following the Commission's guidance and presenting evidence justifying a market rate approach and demonstrating how customers would be shielded from risk, AmBit and Mon Power, instead, filed a petition reflecting substantially the same requests they had made in 2015, but based on a new legal theory. See 2018 Order at 8–9, 11–12, App. at A-180–A-181, A-183–A-184. The companies again sought to eliminate the decrease from $34.25 to $27 for the capacity rate between 2017 and 2036, and, in turn, to eliminate the "return value" that the Commission determined ratepayers were entitled to upon approving the initial increase to the capacity rate in 2006. *Id.*; 2006 Order at 6, App. at A-110. This time, however, AmBit and Mon Power argued that an "all-in levelized avoided cost rate" resulting from the proposed amendments to the EEPA would be lower than the "projected, all-in levelized avoided cost rate" they claimed the Commission tacitly recognized in its 1987 and 1988 Orders, and, therefore,

that the pass-through to customers of the resulting retail rate impacts is just and reasonable. 2018 Order at 12, App. at A-184.

Again, the Commission's Staff, the Consumer Advocate Division, and intervenors West Virginia Energy Users Group and Sierra Club all opposed the companies' request. *Id.* at 15–16, App. at A-187–A-188. During a two-day long evidentiary hearing and in post-hearing briefs, Staff, Consumer Advocate Division, and the intervenors submitted evidence and arguments in opposition to the petition. *Id.* Sierra Club argued, among other things, that neither the 1987 nor 1988 Order established or even contemplated a projected, all-in levelized avoided cost rate—the Commission approved the pass-through of costs based on a fixed capacity rate and a variable energy rate—and that, regardless, the Commission has an independent obligation to determine whether the proposed pass-through results in rates that are just and reasonable. Further, Sierra Club argued that, contrary to the companies' position, Electric Rule 12.6 did not control the outcome of the proceeding because the amendment before the Commission was freely negotiated.

On May 3, 2018, the Commission issued its final order, adopting AmBit and Mon Power's contention that purchased power rates that fall at or below the "levelized avoided cost rate ceiling" are just and reasonable by virtue of their being at or below that ceiling—regardless of whether the rates would be considered just and reasonable upon independent evaluation. *Id.* at 24, App. at A-196. Because neither the original 1987 and 1988 Orders nor any Orders since identified or even contemplated a "projected, all-in levelized avoided cost rate" or "levelized avoided cost rate ceiling," the Commission developed such rate itself by applying a linear trend to the nearly thirty-year-old energy rate forecast that Mon Power was using in October 1988 and extending the forecast—which was only ever intended to predict energy rates through 2005—out through 2035.

Id. at 23, 25, App. at A-195, A-197. By this questionable use of outdated forecasts, the Commission came up with a "levelized avoided cost rate ceiling" of $52.74 per MWh. *Id.* at 33 (Conclusions of Law No. 21), App. at A-205. The Commission further concluded and calculated that increasing the capacity rate provided for in the EEPA to $34.25/MWh for 2017 through the end of the term would line up with the ceiling and, therefore was just and reasonable. *Id.* at 33 (Conclusion of Law No. 25), App. at A-205. Incidentally, that $34.25/MWh rate represents the precise rate that, in a prior 2006 proceeding, AmBit claimed it needed to ensure debt service payments and the continued operation of its plant. *See* 2006 Order at 2, 6, App. at A-105, A-106-110.

Astonishingly, the Commission expects ratepayers to find comfort in the fact that the capacity rate its Order requires them to shoulder between 2017 and 2035 is the same rate they paid between 2006 and 2017—even though that rate was designed to drop after 2017 in order to "allow AmBit to return value to the West Virginia customers of Mon Power . . . for a longer period than [was] provided under the [preexisting] EEPA." 2006 Order at 6 (Finding of Fact No. 7), App. A-110. The Commission did not undertake any independent evaluation of whether the rate recovery contemplated in the 2018 Order—or the impact of eliminating that provision designed to "return value" to ratepayers—was just and reasonable. Nor did the Commission make any attempt to explain or defend its reliance on Rule 12.6 or to respond to the arguments put forth by Staff, the Consumer Advocate, and intervenors. Instead, the Order simply gives the companies exactly what they first sought in their 2015 petition—the increase of the capacity rate to $34.25/MWh. *Id.* at 33 (Conclusions of Law Nos. 25–26) App. at A-205.

On May 14, 2018, the Commission's Staff filed a petition for reconsideration of the 2018 Order. *American Bituminous Power Partners*, Case No. 17-0631-E-C, Staff

Petition for Reconsideration of the Commission Order of May 3, 2018 (May 14, 2018), App. at A-212. Staff argues that the 2018 Order disturbs prior Commission holdings respecting the Grant Town plant, and it highlights the Commission's failure to consider the cost impact to Mon Power's customers. *Id.* at 1–2, App. at A-213–A-214. Staff also argues that the Commission has engaged in improper retroactive ratemaking, *id.* at 2–5, App. at A-214–A-217; that the Order unravels the multi-party negotiated settlement that resulted in the 2006 Order, *id.* at 5, App. at A-217; that the Order violates PURPA and the case law thereunder, *id.* at 5–6, App. at A-217–A-218; and that the Order misconstrues the true nature of the Commission's 1988 Order, *id.* at 6–7, App. at A-218–A-219. The Consumer Advocate Division, West Virginia Energy Users Group, and Sierra Club each submitted letters in support of Staff's petition for reconsideration.

SUMMARY OF THE ARGUMENT

The Public Service Commission's approval of the amended Electric Energy Purchase Agreement between American Bituminous Partners and Monongahela Power Company is premised on a fundamental legal error. If left uncorrected, that error will force West Virginia electric customers to suffer increased electric rates in order to subsidize an unviable plant. In approving the amendment, the Public Service Commission abdicated its responsibility to ensure that rates charged for utility services are just and reasonable.

The Commission's primary error was to misapply a PURPA regulation requiring a utility's purchase of electricity from a "qualifying facility" be deemed just and reasonable so long as the purchase rate is equivalent to the utility's "avoided cost." *See* 18 C.F.R. § 292.304. That rule, however, applies only in an adversarial proceeding where the

Commission is tasked with setting the rate for purchase. It does not apply in a situation, as in the proceedings below, where the qualifying facility and the utility have entered into a voluntary purchase agreement.

The Commission's error was compounded by the fact that the Commission did not, as required by the very regulation it purported to apply, examine the utility's present "avoided costs," opting instead to look back more than thirty years to reconstruct a so-called "avoided cost ceiling" it claims to have set in a 1987 proceeding. As a result, the Commission essentially approved a purchase rate equivalent to the worst possible scenario based on long-stale predictions of the utility's future avoided cost. Even if the PURPA rule declaring purchases "just and reasonable" up to the avoided cost rate were applicable, the plain language of the rule requires it be applied at the time the utility contracts to purchase power from the qualifying facility. Because the proceedings below involved an amendment to a purchase agreement, and thus a new contract, the relevant "avoided costs" under PURPA rules is the present avoided costs, rather than projections of avoided costs from thirty years ago.

STATEMENT REGARDING ORAL ARGUMENT AND DECISION

Oral argument is appropriate under Rule 19 of the Revised Rules of Appellate Procedure because this case involves a narrow issue of law: whether the Commission is required to apply traditional ratemaking considerations before approving the pass-through to consumers of costs arising from a voluntary power purchase agreement between a public utility and a merchant generator qualified as a QF under PURPA. However, because this is an issue of first impression likely to arise again in similar

circumstances, resolution by memorandum opinion under Rule 21 would be inappropriate in this case.

ARGUMENT

I. Standard of Review

The Court must reverse and set aside any Commission order based upon "a misapplication of legal principles," *Monongahela Power v. Public Service Commission*, 166 W. Va. 423, 425, 276 S.E.2d 179, 181 (1981), or any other "mistake of law," *Wilhite v. Public Service Commission*, 150 W. Va. 747, 149 S.E.2d 273, Syl. Pt. 7 (1966). This includes, notably, a misapplication of its own rules and regulations. *See Consumer Advocate Division v. Public Service Commission*, 182 W. Va. 152, 156–58, 386 S.E.2d 650, 654–55 (1989). And in interpreting those rules or regulations, the Court confronts "a purely legal question subject to *de novo* review." *Mountain Communities for Responsible Energy v. Public Service Commission*, 222 W. Va. 481, 489, 665 S.E.2d 315, 323 (2008) (quoting *Appalachian Power v. State Tax Department*, 195 W. Va. 573, 466 S.E.2d 424, Syl. Pt. 1 (1995)).

In reviewing Commission decisions respecting rates, the Court will not "supplant the Commission's balance" of competing interests "with one more nearly to its liking." *Monongahela Power*, 166 W. Va. 423 at Syl. Pt. 2. However, where the Commission has misidentified the "pertinent factors" the law requires it consider, the Court must correct the error and allow the Commission an opportunity to consider those factors on remand. *Id.*

II. The Commission erred in relying on Electric Rule 12.6 to determine rates resulting from the amended agreement were just and reasonable, rather than assessing rate impacts under traditional, cost-based ratemaking considerations.

The Commission can authorize the pass-through of a utility's contract costs only if it determines the resulting impact on rates is just and reasonable. West Virginia Code § 24-1-1(a)(4). The "pertinent factors" that go into that determination, however, change depending on the regulatory framework that governs the contract. If the Commission is acting pursuant to its traditional ratemaking authority, it must consider (among other things) the economic impact on ratepayers; the utility's true cost of service as reflected by current alternatives and market conditions; and any other social, economic, and environmental externalities associated with the contract. West Virginia Code § 24-1-1(b). *See also, Monongahela Power*, Case No. 17-0296-E-PC, Commission Order, 3, 17 & n.6 (January 26, 2018). If, however, the Commission is acting pursuant to its PURPA "implementation jurisdiction"—that is, its authority to compel utilities to purchase from QFs at PURPA-compliant rates—it need only consider whether the rates in the contract equal the utility's avoided cost. 18 C.F.R. §§ 292.303, 292.304; *American Paper Institute*, 461 U.S. at 416-417.

The Commission apparently believed itself to be acting under its PURPA authority below. It disclaimed any duty to consider whether the rates in the amended EEPA "would be considered just and reasonable outside of the PURPA" context, 2018 Order at 24, App. at A-196, and expressly declined to address the parties' arguments about the economic and environmental impacts of the amended EEPA, *id.* at 26, App. at 198. Instead, the Commission concluded that the amended rate was *per se* just and reasonable because it did not exceed an "all-in levelized avoided cost rate ceiling" it

claimed to have "established" in 1987. *Id.* at 24, App. at 196.

The Commission erred. PURPA's avoided-cost standard applies only to rates a utility is *compelled* to pay under PURPA's mandate. The standard does not apply to a completely voluntary agreement between a utility and a QF—particularly one that amends an existing, already-approved agreement. Furthermore, by applying only the avoided-cost standard, the Commission failed to discharge its *actual* duty under the law: a review of the amended EEPA and its impact on customers according to traditional ratemaking principles. Stated otherwise, the Commission's misapplication of the law resulted in a failure to consider the "pertinent factors" the law requires.

A. *Electric Rule 12.6 applies to PURPA contracts compelled by Commission order, not to voluntary changes to existing agreements.*

Like its federal counterpart and its analogs in other states, Electric Rule 12.6.2 "merely ensures that a utility can recover the full amount of the payment it is *compelled* to make" under PURPA. *Public Utility Commission v. Gulf States Utilities*, 809 S.W.2d 201, 208 (Tex. 1991) (emphasis in original). As the U.S. Supreme Court noted in *American Paper*, the avoided-cost standard is different from the traditional, cost-of-service based regulation most utilities operate under. 461 U.S. at 414. Therefore, both Rule 12.6.2 and 18 C.F.R. § 292.304(a)(2) are designed to shield utilities from the disallowance of costs that federal law requires they incur for reasons generally unrelated to typical ratemaking considerations.

Rather than a shield, the Commission's decision below allows AmBit and Mon Power to use the regulations as a sword. No law, state or federal, compels Mon Power—let alone its ratepayers—to incur the costs associated with the amended EEPA. Thus, there is nothing from which Mon Power needs to be shielded. Applying the regulations

in this situation fails to serve *any* compelling state or federal interest; it merely punishes ratepayers for Mon Power's voluntary decision to join AmBit's cause.

Courts and commissions alike have appropriately held that regulations like Electric Rule 12.6 simply do not apply in such a situation. In *Gulf States*—a case the Commission has cited approvingly, *see* 2016 Order at 33, App. at A-149—the Supreme Court of Texas reviewed the utility commission's interpretation of a Texas regulation declaring that "[r]ates which equal avoided cost are deemed to be just and reasonable." *Id.* at 204.[3]

While acknowledging that the state commission's interpretation of its own regulation was entitled to deference, the court found that the "clear, unambiguous language" of the rule operates "solely to set the rates that the [c]ommission can *compel* a utility to pay for a QF's power if the utility and QF are unable to reach a voluntary agreement." *Id.* at 207 (emphasis in original). The court explained that the rule "merely ensures that a utility can recover the full amount of the payments it is *compelled* to make by the commission." *Id.* at 208 (emphasis in original). Where the utility is not so compelled, the agreement falls outside of the express scope of the PURPA regulations, and the utility's ability to recover the costs of the agreement is determined solely according "to the [c]ommission's ordinary ratemaking powers." *Id.* at 208–09. In other words, the commission must analyze the agreement according to its effect on the utility's ratepayers and on the public interest. *Id.* at 209 & n.14.

The *Gulf States* decision is in line with other courts and commissions that have concluded the avoided-cost standard does not apply to freely negotiated agreements. *See,*

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3 The Commission has specifically recognized the similarity between Texas' rule and its own Rule 12.6. *See* 2016 Order at 33.

e.g., *In re Vicon Recovery Systems*, 572 A.2d 1355, 1358 (Vt. 1990) ("The rate provisions of [18 C.F.R.] § 292 apply only where . . . the electric utility is *forced* to purchase power from the small producer.") (emphasis added); *Independent Energy Producers v. California Public Utilities Commission*, 36 F.3d 848, 851 (9th Cir. 1994) (FERC's Section 210 regulations "regulate the purchase of energy by utilities from QFs *as required* by § 210") (emphasis added); *Barasch v. Pennsylvania Public Utility Commission*, 546 A.2d at 1300 ("[P]rivately negotiated contracts for QF power are essentially outside the federal and state [PURPA] rules.").

As in *Gulf States*, these decisions similarly recognize that traditional "state regulatory oversight" instead applies to voluntary contracts between utilities and QFs. *Vicon Recovery*, 572 A.2d at 1358; *Hopewell Generation v. Virginia State Corporation Commission*, 453 S.E.2d 277, 282 (Va. 1995) (recoverability of costs in freely negotiated contract must be analyzed under traditional ratemaking principles, even though costs were below the utility's avoided cost as determined in prior proceeding); *In re East Georgia Cogeneration*, 614 A.2d 799, 804 (Vt. 1992) (where "the proposed project seeks rates higher than those mandated by federal law," approval hinges on "concern for ratepayers" rather than "return on the investment of entrepreneurs").

B. *Commission jurisdiction over PURPA contracts is limited to initial contract formation.*

Furthermore, using the avoided-cost standard to approve amendments to an *already-existing,* previously approved PURPA agreement ignores the limited nature of the Commission's implementation authority under federal law. "Jurisdiction under [PURPA] is generally limited to supervision of the contract formation process. Once a binding contract is finalized, however, that jurisdiction is usually at an end." *In re*

Florida Power, Case No. 940771-EQ, Order Granting Motions to Dismiss, 8 (Fla. P.S.C. February 15, 1995) (*Florida Power I*), available at https://bit.ly/2JtggZ2 (quoting *Erie Associates*, Case No. 92-E-0032, slip op. 192 (N.Y.P.U.C. March 4, 1992)). Under federal law, the Commission's implementation authority "end[s] with [its] approval of the" initial PURPA contract. *Freehold Cogeneration v. Board of Regulatory Commissioners*, 44 F.3d 1178, 1192 (3d Cir. 1995). *See also Crossroads Cogeneration v. Orange & Rockland Utilities*, 159 F.3d 129, 138 (3d Cir. 1998) ("Though FERC did allow state agencies to approve [such] agreements, the implementation authority of state agencies end[s] once an agreement is approved.").

A contract between a utility and a QF "is evaluated for cost recovery purposes in accordance with" the PURPA regulations *only* "[w]hen the Commission initially approves" it. *In re Florida Power*, Case No. 961477-EQ, Order Denying Petition to Approve Settlement Agreement, 13 (Fla. P.S.C. November 14, 1997) (*Florida Power II*), available at https://bit.ly/2Js9i6w. The Commission acknowledged that fact when it promulgated Rule 12, explaining that its involvement in establishing rates under that Rule "is triggered by the inability of the QF and utility to negotiate a mutually acceptable rate." *In re Implementation of Rules to Encourage Cogeneration and Small Power Production*, General Order No. 206, Proposed Rule and Opportunity to Comment, 2 (August 20, 1981). Like its state and federal counterparts, the Rule simply does not apply to subsequent negotiations, the "cost recovery [of which] is based on savings compared to the existing contract," *id.*—or, in certain cases, presently-available alternatives. *See, e.g.*, *Pacific Gas and Electric*, Case No. A89-03-036, Opinion, 5 (Cal. P.U.C. November 22, 1989), available at https://bit.ly/2HjNPYr (considering market alternatives to an existing PURPA contract because QF was unviable and, as a

consequence, the contract itself no longer represented the utility's avoided cost).

Therefore, while the Commission may approve an amendment to the terms of an existing EEPA upon the agreement of the parties, its authority to do so arises from its general jurisdiction to oversee the rates and practices of the utilities it regulates—not from its implementation authority under PURPA. The Commission's previous rulings recognize that distinction, *see* 2016 Order at 52 (Conclusion of Law No. 6), App. at A-168 (citing West Virginia Code § 24-1-1(a), § 24-2-3, § 24-2-4a), as do the decisions from commissions in other states, *see, e.g.*, *Application of Pacific Gas & Electric*, Case No. A14-10-002, Decision Granting Amendment to Pacific & Electric Company Amended Power Purchase Agreement with Rio Bravo Poso, 5 (Cal. P.U.C. February 13, 2015), available at https://bit.ly/2kLP4GX ("[T]he modification of a QF contract should only be agreed to if commensurate concessions are made to the benefit of ratepayers. . . . [T]he financial impact on the ratepayer is a prime consideration for determining if a contract amendment should be deemed reasonable.") (internal alterations omitted); *In re Jersey Central Power & Light*, No. EM88010206, 1993 WL 304634 (N.J. Bd. Reg. Comm'rs May 11, 1993) (assessing amendment to QF contract according to its "adverse impact upon [utility] ratepayers").

In short, there is no authority under federal or state law for using PURPA's avoided-cost standard to approve the rate impacts arising from a freely negotiated and wholly voluntary amendment to an existing PURPA agreement. The Commission therefore erred in approving the rates in the amended EEPA based solely on that standard. And as a consequence of that error, it failed to apply the appropriate standard for recovery of costs: the impact of the agreement on ratepayers and the broader public interest.

III. To the extent Electric Rule 12 *does* govern the Commission's review of a voluntary EEPA amendment, the Commission erred by failing to assess the amended rates against the utility's *present* avoided costs.

Even assuming, for the sake of argument, that PURPA and its avoided-cost standard were relevant to the Commission's approval of the amended EEPA, the Commission misapplied that standard. A careful reading of the relevant regulations demonstrates that the "avoided cost" deemed *per se* just and reasonable is the avoided cost *at the time an obligation to pay those rates is incurred.* Because the Commission instead used as its benchmark the stale conditions surrounding a long-since superseded contract, it failed to properly apply PURPA regulations on even their own terms.

To briefly review those terms, Rule 12.6.b requires that rates for purchases of QF capacity "shall equal the avoided costs" of the utility. West Virginia C.S.R. § 150-3-12.6.b.2. As AmBit emphasized before the Commission below, Rule 12.6.c allows a QF to "lock in" rates over the "specified term" of the "legally enforceable obligation." *Id.* § 150-3-12.6.c.2.B. When it opts to do so, however, the Rule requires those rates be based on the utility's "avoided cost *calculated at the time the obligation is incurred.*" *Id.* § 150-3-12.6.c.2.B (emphasis added). In sum, it is only *those* rates—*i.e.*, rates calculated according to avoided cost at the time the contract is entered into (and, consequently, the "legally enforceable obligation is incurred")—that Rule 12.6.b.2 deems *per se* reasonable. *Id.* §§ 12.6.b.1, 12.6.b.2.

The "rates" at issue in this case are the rates in the *amended* EEPA. *See* 2018 Order at 33 (Conclusion of Law No. 20), App. at A-205. Therefore, assuming that the amendment falls within the scope of PURPA regulations at all, the rates contained therein are *per se* reasonable *only* if they reflect estimates of Mon Power's avoided costs

at the time the legal obligations of the *amended* EEPA are incurred. In fact, AmBit's own expert on the amended EEPA's "legal and policy basis under PURPA" testified that, where a QF and a utility seek to amend an existing EEPA, the proper reference point for determining the "avoided cost" of the amended contract is at the time of *amendment*:

> a levelized rate is a fixed rate that is determined at the time the "legally enforceable obligation" to purchase the QF's power is incurred, that is, when the parties enter into a contract or *upon amendment of a contract* that is mutually agreed upon by the parties.

American Bituminous Power Partners, Case No. 17-0631-E-P, Direct Testimony of William D. DeGrandis, 3 (May 18, 2017) (emphasis added).

The Commission followed a decidedly different path. It explains in its 2018 Order that it determined the rates in the amended EEPA to be *per se* just and reasonable merely because they fell below Mon Power's "avoided cost . . . contemporaneous with approval of the *original* EEPA." 2018 Order at 24 (emphasis added). But the "avoided cost" that PURPA sanctions as *per se* just and reasonable is the "avoided cost" at the time the "legally enforceable obligation" regarding those rates attaches. The Commission's Order does not purport to determine *that* avoided cost and, in fact, expressly eschews any consideration of "current alternatives or current market conditions." *Id.* at 33 (Conclusion of Law No. 20), App. at A-205. Yet, currently available alternatives are precisely what the Commission must consider in determining "avoided cost." *See American Paper*, 461 U.S. at 406 ("avoided cost" refers to the incremental cost of *alternative* sources of energy); *Conservation Law Foundation v. Public Utilities Commission*, 163 A.3d 132, 141 (Me. 2017) (commission properly calculated avoided cost according to most current market information). *See also Jersey Central Power*, 1993 WL 304634 (the "appropriate economic benchmark" to evaluate amendment to QF

agreement is "present market prices"); *In re Duke Energy Florida*, Case No. 20170248-EI, Order Approving Fuel Cost Proxy Substitution, 2 (Fla. P.S.C. February 26, 2018), available at https://bit.ly/2LlQtzn (modifications to existing PURPA contracts must be evaluated "against both the existing contract and the current value of the purchasing Utility's avoided cost").

In short, AmBit and Mon Power asked the Commission to approve rates contained in a *new* "legally enforceable obligation." By the Commission's own admission, that approval hinged solely on whether those costs reflected Mon Power's "avoided cost" as that term is used in Electric Rule 12.6. 2018 Order at 33 (Conclusion of Law No. 33), App. at A-205. But because the term "avoided cost" in Rule 12.6 refers specifically to the cost at the time the "legally enforceable obligation" under review is incurred, the Commission erred in looking instead to the conditions surrounding a long-since abrogated agreement—one that was neither "enforceable" nor "obligatory" on either party. To the extent, therefore, that PURPA regulations applied at all in this case, the Commission's failure to properly apply them warrants reversal.

CONCLUSION

For the reasons above, the Sierra Club respectfully requests this Court remand the Commission's decision for further review under the applicable legal principles.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on June 4, 2018, I delivered a true and correct copy of the foregoing Opening Brief of the Petitioner to the following, via hand delivery.

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